No. 7119

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 24663

JAMES R. WATKINS AND LUCILE L. WATKINS,
Plaintiffs-Appellants

vs.

UNITED STATES OF AMERICA,
Defendant-Appellee

On Appeal From the United States District Court for the District of Connecticut

BRIEF FOR PLAINTIFFS-APPELLANTS AND APPENDIX

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BRIEF FOR PLAINTIFFS-APPELLANTS

JURISDICTION

This appeal involves claims for refund of federal income taxes for the years 1949, 1950, 1951 and 1952. The judgment of the District Court was entered on March 12, 1957 and the plaintiffs filed a notice of appeal on April 10, 1957. The jurisdiction of this Court is invoked under the provisions of 28 U. S. C., Section 1291.

STATEMENT

The facts found by the District Court are:

1. On April 17, 1934 there was issued to the plaintiff, James R. Watkins, (hereinafter referred to as "plaintiff") U. S. Letters

Patent No. 1,955,107 covering a wood cleated corrugated shipping container.

2. Subsequently, additional Letters Patent were issued to him for improvements on the shipping container as follows:

October 9, 1934, Letters Patent No. 1,976,693
December 27, 1938, Letters Patent No. 2,141,497; and
May 13, 1939, Letters Patent No. 2,159,642

3. In March, 1937, plaintiff entered the employ of Dillman Industries, Inc. and at that time entered into an agreement with it whereby he granted to it a non-exclusive license to manufacture containers under the patents which, up to that time, had been issued to him.

4. The manufacture and sales of the shipping containers proved to be successful and early in 1940 negotiations went on between plaintiff and some of the officers and leading shareholders of Dillman Industries, Inc., acting both on behalf of the corporation and themselves, personally, relative to new agreements for the exploitation of the patents.

5. During said period a new corporation, Watkins Patents, Inc., was organized under the laws of the State of Illinois, in which plaintiff owned twenty per cent of the shares issued and outstanding and the remaining eighty per cent of said shares were owned by Dillman Industries, Inc. or officers or shareholders of Dillman Industries, Inc.

6. On April 17, 1940, certain agreements were entered into as follows:

(a) Between plaintiff and Watkins Patents, Inc.—Exhibit A;

(b) Between Watkins Patents, Inc. and Dillman Industries, Inc.—Exhibit B;

(c) Between Dillman Industries, Inc. and plaintiff—Exhibit C;

(d) Between plaintiff, Dillman Industries, Inc. and Watkins Patents, Inc.—Exhibit D;

(e) Between Watkins Patents, Inc. and plaintiff—Exhibit E.

We do not believe that the general summary of these five agreements made by the District Court in Paragraph 6 of its Findings of Fact is completely accurate. Three typewritten copies of each agreement will be filed with this brief.

QUESTIONS PRESENTED

Defendant's Answer admitted that the patents constituted capital assets, within the meaning of Section 117 of the Internal Revenue Code of 1939, as amended, and had been held for longer than the period of time required to qualify them as long term capital assets. Only the issue of liability was tried before the District Court, the parties having agreed that in the event judgment should be ordered for plaintiffs, they would attempt to stipulate the amount of such judgment. This admission and agreement left as the only issue to be decided by the District Court the question as to the legal effect of Exhibit A—whether that agreement constituted a sale of the patents so that the amounts received by plaintiff as royalties during the years 1949 and 1950 constituted long term capital gains under Section 117 (a) (4) of the Internal Revenue Code of 1939, as amended, which is the statute applicable to the years 1949 and 1950, and whether that agreement constituted a transfer of property consisting of all substantial rights to a patent under Section 117 (q) of the Internal Revenue Code of 1939, as amended, which is the statute applicable to the years 1951 and 1952, or whether the amounts received constituted ordinary income for all years.

STATUTES INVOLVED

Section 117 (a) (4) of the Internal Revenue Code of 1939, as amended, provides:

"Sec. 117. (a) Definitions.—As used in this chapter—

* * * *

(4) Long-Term Capital Gain.—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income;"

Section 117 (q) was added to Section 117 in 1956 by Act of June 29, 1956, c. 464, 70 Stat. 404, Public Law 629, 84th Congress, 2nd Sess. and provides:

"(q) TRANSFER OF PATENT RIGHTS—

(1) General Rule—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(A) payable periodically over a period generally coterminus with the transferee's use of the patent, or

(B) contingent on the productivity, use, or disposition of the property transferred.

(2) 'Holder' Defined.—For purposes of this subsection, the term 'holder' means—

(A) any individual whose efforts created such property, or

(B) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(i) the employer of such creator, nor

(ii) related to such creator (within the meaning of paragraph (3)).

(3) Exceptions.—This subsection shall not apply to any transfer described in paragraph (1)—

(A) by a nonresident alien individual, or

(B) between an individual and any related person.

For purposes of this paragraph, the term 'related person' means a person, other than a brother or sister (whether of the whole or half blood), with respect to whom a loss resulting from the transfer would be disallowed under section 24(b).

(4) Applicability.—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer described in paragraph (1) in any taxable year beginning after May 31, 1950, regardless of the taxable year in which such transfer occurred."

SUMMARY OF POINTS

1. Exhibit A constituted a sale or transfer of all substantial rights to the patents within Section 117 (a) (4) and 117 (q) of the Internal Revenue Code of 1939.

2. Assuming that Watkins Patents, Inc. did not receive the rights to make, sell or use the invention but only the exclusive right to license others, the right to prosecute and defend infringement actions and the rights of plaintiff in outstanding licenses, Exhibit A constituted an assignment.

3. Provisions constituting conditions subsequent included for the protection of plaintiff's rights to payment and of the assignee's title do not change Exhibit A from an assignment to a license.

ARGUMENT

Exhibit A constituted a Sale or Transfer of All Substantial Rights to The Patents Within Section 117 (a) (4) and 117 (q) of The Internal Revenue Code of 1939.

Stated generally, the sole issue before this Court is whether the agreement between plaintiff and Watkins Patents, Inc., Exhibit A, effected a sale or assignment of the patents on the one hand or a license on the other. In concluding that this agreement "was only the grant of a license," the District Court said:

> ". . . Such a study makes it apparent that what was transferred by Watkins to Watkins Patents, Inc. was the power to license or, as the court described it in *Six Wheel Corporation* v. *Sterling Motor Truck Co.*, 50 F 2d 568 (Ninth Circ.) at 573, the 'license to license.'
>
> ". . . The power to license with the incidental protective right to conduct or participate in infringement actions, and the rights in outstanding licenses were the only incidents of ownership which any of the parties intended to have conveyed and were in fact the only interests conveyed by James R. Watkins to Watkins Patents, Inc. . . ." (App. pp. 22-23).

By Article II of Exhibit A plaintiff "does hereby transfer and grant" to Watkins Patents, Inc.:

> ". . . . the non-transferable exclusive license for the use of and sub-licensing under each and all of the above referred to patents, including each and every part or subdivision thereof, together with the improvements thereon or extensions thereof for the life of said patents and each of same, or any part or parts or subdivisions thereof. . . ."

The District Court rejected the testimony of plaintiff and Messrs. Weis and Dillman that they intended that complete ownership of the patents should be transferred to Watkins Patents, Inc. (App. pp. 6, 11-14) and also the uncontroverted testimony of

the distinguished attorney who drew up the agreements that "the idea was to sell the patents . . . to this new corporation, Watkins Patents, Inc., that is in 1940, and this was done" (App. p. 16) on the sole ground that "neither any such words ("complete ownership" or "ownership") nor their legal equivalents were used in the lengthy written agreements drafted by their counsel." (App. p. 24). It then held that testimony of the same witnesses that their intention was to have Watkins Patents, Inc. issue licenses limited the meaning of "use" in Article II of Exhibit A to "exploitation of the patents by issuing licenses." Such restriction results in the word "use" having no purpose in the granting clause, since that clause already expressly grants the right of "sub-licensing." The District Court's construction makes the clause read that plaintiff does hereby transfer and grant "the non-transferable exclusive license for the issuing of licenses and sub-licensing under each and all of the above referred to patents . . . ." and so the Court concludes that the rights to make, use and sell the product were not transferred to Watkins Patents, Inc.

With this brief explanation of the District Court's initial position, an examination of Exhibit A is in order. It purports to transfer and grant an "exclusive license;" the use of that term does not prevent the transfer from constituting an assignment.

> "Whether a transfer of a particular right or interest under a patent is an assignment or a license does not depend upon the name by which it calls itself, but upon the legal effect of its provisions. . . ." *Waterman* v. *MacKenzie*, 138 U. S. 252, 256.

Some of the many decisions holding the transfer to be an assignment notwithstanding use of the term "license" by the parties are:

Watson v. *United States*, (CA10) 222 F 2d 689, 691;
Rollman v. *Commissioner*, (CA4) 57-1 USTC 9677;
United States v. *Carruthers*, (CA9) 219 F 2d 21;
Reed v. *Commissioner*, 26 T. C. 622.

In fact, in *Pike* v. *United States*, (D. C. Conn.) 101 F. Supp 100, the agreement expressly provided that: "This agreement shal be construed as a license of the aforesaid patents and not as an assignment thereof from Pike to Westvaco," but Judge Hincks held, on the basis of other provisions, that the agreement constituted an assignment of the patents.

Obviously, the transfer of an "exclusive license" is even more indicative of an assignment than is the transfer of a "license." In *Goldsmith* v. *Commissioner*, (CA2) 143 F 2d 466, Judges Learned Hand and Swan held that the grant of an "exclusive license" under a copyright was a sale. At page 468 of that decision, Judge Hand said:

> ". . . It does not unduly strain the meaning of 'sale' to make it include an exclusive license; in the case at bar the parties themselves used the words 'grant and assign' . . ."

In the instant case, Exhibit A uses the term "transfer and grant" and in *Niagara Hudson Power Corporation* v. *Hocy* (CA2) 117 F 2d 414, 416; cert. denied, 313 U. S. 571, this Court said:

> ". . . But in legal jargon a change of ownership, terminating rights and other relations in one entity and creating them in another, is the essence of 'transfer' . . ."

The "transfer" of an "exclusive license" would seem to be much closer to an assignment than to a license.

The District Court admitted that "under certain circumstances and in certain contexts" the transfer and grant of "the non-transferable exclusive license for the use of an sub-licensing under each and all . . . the patents" could be construed as an assignment or sale, although it referred to this language of Exhibit A, as "such an imprecise expression of assignment or sale." (App. p. 21). With the latter we differ strongly. The United States Supreme Court has frequently employed the term "use the

patent" as meaning "make, use and sell under the patent." For instance, in *Hartford-Empire Co.* v. *U. S.*, 323 U. S. 386, 417, the Court considers a paragraph in the decree of the lower court:

> "Under paragraph 24(b) a defendant hereafter acquiring a patent cannot set the price for its use by others, elect to use it himself and refuse to license it, or to retain it and neither use nor license it. These are options patent owners have always enjoyed."

And at page 432, the Court says:

> "A patent owner is not in the position of a quasi-trustee for the public or under any obligation to see that the public acquire the free right to use the invention. He has no obligation either to use it or to grant its use to others. . . ."

In *Continental Paper Bag Co.* v. *Eastern Paper Bag Co.*, 210 U. S. 405, at page 425, there appear two statements as to what an inventor receives from a patent. The quotation is:

> ". . . It shows that whenever this court has had occasion to speak it has decided that an inventor receives from a patent the right to exclude others from its use for the time prescribed in the statute. . . .
>
> "And, in *Bloomer* v. *McQuewan*, 14 How. 539, 549, Chief Justice Taney said: 'The franchise which the patent grants consists altogether in the right to exclude everyone from making, using or vending the thing patented, without the permission of the patentee. That is all he obtains by the patent'."

It seems clear that "the right to exclude others from its use" in the first sentence is synonymous with "the right to exclude everyone from making, using or vending the thing patented" in the second. This point is made in *Daily* v. *Universal Oil Products Co.*, (D. C. Ill.) 76 F. Supp. 349, at page 356:

> "It seems clear that the transfer of the exclusive use and control of the patent No. 646,639 and the process covered thereby, to Sunset Oil Refining Company under the agree-

ment of May 5, 1900, constituted an assignment of the title of the patent. . . .

"The grant of the exclusive use and control of the process in patent No. 646,639 was not less than the right to make, to use and to vend the processs covered by the patent and the products created by the process. . . ."

We submit that it is well established by usage of the United States Supreme Court that a transfer of the exclusive use of a patent is a precise expression of an assignment of the right to make, use and sell under the patent. Innumerable instances of this usage of the term "use of the patent" by other authorities could be produced.

In several other tax cases in which the term "use the patent" or its equivalent was employed, the Courts held that an assignment was effected. In *Associated Patentees, Inc.* v. *Commissioner*, 4 T. C. 979 and in the connected case of *United States* v. *Borton*, (D. C. N. J.) 50-1 USTC 9276, four individuals entered into an agreement with a corporation which they formed and in which each had a twenty-five per cent interest, which provided that "in consideration of the use of numerous patents," the corporation agreed to pay "as royalties for the use of the patents and inventions turned over," twenty per cent of all royalties received by the corporation from licenses. Both the Tax Court and the District Court held that the agreement constituted a sale of the patents.

In *Reid* v. *Commissioner*, supra, petitioner gave a corporation the exclusive right "to utilize her design patents and/or process patents . . ." The Tax Court held, and the Commissioner has acquiesced in the decision, 1956-47 Int. Rev. Bull. 6, that a "complete assignment was intended and made, and that the exclusive right to 'use' petitioner's name and patents throughout the United States for the full period of their existence was transferred . . ."

In *Pike* v. *United States*, supra, plaintiff granted and conveyed "the exclusive right and license to practice and use the processes described and claimed in the aforesaid patents . . ." and the Court held that an assignment was effected.

Finally, in the recent case of *Gruber* v. *United States*, (D. C. Ore.) 57-2 USTC 9762, the agreement gave ". . . the sale and exclusive right and license to use" the patent and the Court held that it constituted an assignment.

We submit that there is absolutely no difference between these cases and the instant case insofar as the construction of the phrase "use of the patents" is concerned. Plaintiff as patentee originally had the exclusive right to use the patents as he saw fit; in his use of the patents he could manufacture, sell and use the container, the transfer by him of the exclusive right to use the patents was, in the words of the Court in *Daily* v. *Universal Oil Products Co.*, supra, "not less than the right to make, to use and to vend" the containers covered by the patents. Watkins Patents, Inc. received these rights by assignment; the fact that the parties did not intend to have the corporation manufacture should not change the legal effect of the transfer to it. The argument of the District Court is that to accomplish the exploitation of the patents, Watkins Patents, Inc. did not need the rights to make, use and sell but only the power to license; that since it did not need these powers, the parties did not intend it to have them and so it did not receive them. The case relied upon by the Court, *Six Wheel Corporation* v. *Sterling Motor Truck Co.*, supra, involved a corporation which was expressly prohibited by agreement from manufacturing, using and selling. In the instant case there is absolutely no prohibition upon Watkins Patents, Inc.; there is a great deal of difference between a prohibition against manufacture and an intention not to exercise the right to manufacture. The fact that it was not intended that Watkins Patents, Inc. manufacture and sell did not prohibit it from doing so; in fact, it was incorporated as an ordinary manufacturing corporation. (Tr. p. 83).

This conclusion of the District Court is completely contrary to the testimony of the parties to the negotiations—the plaintiff who acted in his own interest and Messrs. A. W. D. Weis and K. W. Dillman, who acted in the interests of themselves, Dillman Industries, Inc. and Watkins Patents, Inc. Mr. Weis testified that the plaintiff was selling and his interests were buying (App. p. 14), that their intentions were that, for the life of the patents and any improvements thereon, they would have ownership of them (App. p. 14). Mr. Dillman testified:

> "But we were not willing to go ahead with this thing unless we could have the complete ownership of it, because we realized we were going to have to spend an awful lot of money. When we finally did go ahead, we spent over $50,000 on one experimental machine." (App. p. 6).

In answer to a question by the Court, Mr. Dillman said:

> "Q. You say that you wanted something more than a license. You wanted to own the patent is that it? A. That is right. If we were going to go ahead and put more money in it and expand this operation, yes, sir." (Ap. p. 6).

Later he testified:

> ". . . And Mr. Weiss stated that he was willing to go along with it and to have Dillman Industries provide the financing for it, but only so long—we told Mr. Watkins very definitely at that time—that only so long as we had complete ownership of the patents." (App. p. 6).

The District Court relies considerably on the following questioning which happened on cross-examination:

> "Q. That, is, the Watkins Patents, Inc sole job was to handle the sub-licensing? A. It was to handle the licensing of licenses.
>
> "Mr. WEIR. I object to that, your Honor. I don't recall any testimony to that effect.

"The COURT. Well, obviously it would include the interest in the patents, the holding of the interest in the patents. Is that the objection.

"Mr. WEIR. Well, that is the objection. I think he used the word 'sole.'

"The COURT. He said solely. By that you didn't mean, I take it, to exclude the patents because they couldn't very well grant licenses if they didn't have any interest in the patents?

"Mr. GITELMAN. No. What I am driving at is that Watkins Patents, Inc. was not created to manufacture boxes.

"A. No, we didn't." (App. pp. 9-10).

This episode is the only evidence upon which the Court relied in holding that the "sole" job of Watkins Patents, Inc. was to issue licenses although the District Court itself pointed out that the corporation couldn't grant licenses unless it had an "interest" in the patents. A licensee has no proprietary interest in patents. Furthermore, this testimony does not support a conclusion that because the parties did not intend that Watkins Patents, Inc. manufacture under the patents, they did not intend to transfer ownership of the patents to that corporation. What the District Court by hindsight thought that Messrs. Weis and Dillman needed to accomplish their purpose is not important, what they themselves thought they needed at the time is very important. They thought they needed ownership of the patents to protect both the money they were putting into the corporation and the cost of the machinery which they were developing for making the container. That was their uncontroverted testimony. The conclusion of the District Court that all they needed was a license and therefore that is all they got is not supported by any evidence. What they thought they needed was "complete ownership" and that is what they thought they received. Mr. Dillman quotes Mr. Weis as saying to plaintiff on the occasion of subsequent discussions:

". . . . 'We own this patent. You don't have a damn thing to do with it now'." (App. p. 9).

Defendant did not even bother to cross-examine Mr. Lancaster That distinguished member of the Illinois Bar for over fifty years testified on deposition that ". . . in 1940 the idea was to sell the patents. I think there were four if I remember rightly, to this new corporation, Watkins Patents, Inc., that is in 1940 and this was done. . . ."

Other provisions of Exhibit A clearly indicate that an assignment was intended and effected. Article VII requires that Watkins Patents, Inc. establish a fund of Ten Thousand Dollars "for the purpose of defraying any expense incurred by it in litigation for protection of the aforesaid patents." Article VIII provides that if Watkins Patents, Inc. exhausts said fund and refuses to "continue to prosecute or defend further said patent litigation," plaintiff could then take over and if the "conclusion of said litigation sustains the issues in favor of Second Party" (Watkins Patents, Inc.), plaintiff would be reimbursed for his expenses out of the first royalties thereafter collected. These provisions would seem to compel a conclusion that an assignment and not a license was intended since a licensee has no right to sue infringers. *E. W. Bliss Co. v. United States*, 253 U. S. 187, 192; *Littlefield v. Perry*, 21 Wall. 205, 223. In *Ellis, Patent Assignments*, Sec. 55, the author states:

> ". . . The broad fundamental practical difference between an assignment and a license is that the former gives the transferee the right to sue for infringement and the latter gives the transferee immunity from suit for infringement. The first gives positive rights, the second negative rights."

Once again we turn to the Pike decision, supra. At page 101, Judge Hincks states:

> ". . . The agreement shows that intent to be that Westvaco for the life of the patent should not only have the exclusive right to practice the processes and to license others but, very significantly, the right to enforce the patents against infringers in its own name, retaining as its own any recov-

> eries so obtained. Thus the operative intent was plainly to pass all the rights the plaintiff had. A transaction having such an intended effect was an assignment of the proprietary interest and hence in legal effect a sale. . . ."

The similar facts that Exhibit A gives Watkins Patents, Inc. the exclusive use of the patents with the right to license others, the right to prosecute and defend infringement suits in its own name and obviously contemplates that, after payment of expenses, recoveries shall be retained by it, are significant indications in this case that an assignment of the proprietary interest was intended and effected.

Also indicative of an assignment are the provision of Article II of Exhibit A expressly transferring to Watkins Patents, Inc. "all licensing agreements heretofore made under said patents" by plaintiff and the provision of Article XII requiring plaintiff to deliver to Watkins Patents, Inc. an additional assignment of these prior licenses in proper form for filing in the Patent Office. Thereafter the licenses outstanding were beyond question owned by Watkins Patents, Inc. but under the District Court decision it owned neither the patents nor the licenses thereafter issued by it. Obviously, the parties did not contemplate such a situation but intended that the provisions for assignment of the prior licenses should coincide with the assignment of the patents and place the complete ownership of all interests in Watkins Patents, Inc. As stated in *Hook* v. *Hook & Ackerman, Inc.* (CA3) 187 F 2d 52, 58:

> "The assignment to the corporation of the non-exclusive license previously granted to Sears, Roebuck and Co., further emphasizes the fact that there was an intent to pass full ownership to the corporation. . . ."

The surrender by Dillman Industries, Inc. of the license issued to it by plaintiff and the issuance of a new license (Exhibit B) from Watkins Patents, Inc. to it is still further indication of where the parties intended ownership to rest as is the issuance

by Watkins Patents, Inc. to plaintiff of a license (Exhibit E). The issuance of these two licenses by Watkins Patents, Inc. is a practical construction of Exhibit A by the parties and is very conclusive evidence that the parties contemplated that all proprietary rights should be transferred to Watkins Patents, Inc. by Exhibit A. Exhibit E is also clear evidence that plaintiff intended to give up all right to manufacture and sell since he felt that he needed a license from Watkins Patents, Inc. to do so. If Exhibit A transferred only the power to license then Exhibit E was entirely unnecessary and Exhibit B should have run from plaintiff to Dillman Industries, Inc. as did the prior license.

We respectfully submit that all of these provisions clearly indicate that a transfer of "complete ownership" of the patents was intended. As pointed out, supra, the District Court rejected testimony by the parties to the negotiations that they so intended on the sole ground that "neither any such words nor their legal equivalents were used in the lengthy written agreements . . . ." Obviously the words "ownership" and "complete ownership" do not appear in the agreements but the provisions hereinbefore discussed are the legal equivalents of those expressions. Obviously, too, we would not be in court if the agreements were more specific nor would the other cases have been before the courts on this point if the agreements were not subject to some construction.

II

Assuming That Watkins Patents, Inc. Did Not Receive the Rights to Make, Sell or Use the Invention But Only the Exclusive Right to License Others, the Right to Prosecute and Defend Infringement Actions and the Rights of Plaintiff in Outstanding Licenses, Exhibit A Constituted an Assignment.

The practical effect of the District Court's decision that the transfer of the exclusive right to use a patent and to issue licenses

thereunder to a corporation formed for the purpose of engaging in the business of issuing licenses cannot be an assignment but is only a license to license is that a holding company cannot be the owner of patents. If correct, the decision is of far reaching importance in view of the thousands of such companies which must now exist. The Hartford-Empire Company was an outstanding example—it was purely a patent holding company engaged in licensing others. In *Hartford-Empire Co.* v. *United States*, 323 U. S. 386, it was sued as the owner of patents. In *Associated Patentees, Inc.* v. *Commissioner, supra,* and *United States* v. *Borton, supra,* both the Tax Court and the District Court held that Associated Patentees, Inc. was the owner of patents by assignment although it engaged solely in the business of licensing others. Similarly, in *Massey* v. *United States,* (CA7) 226 F 2d 724, the finding of facts discloses that the assignee was not a manufacturer.

The District Court's argument is that because the parties did not intend that Watkins Patents, Inc. manufacture, use and sell under the patent, plaintiff did not intend to transfer those rights to that corporation and the term "use of the patent" is not to be given a recognized and established meaning but is to be given the very restricted and unusual meaning of "issue licenses under the patent." This position fails to recognize that Watkins Patents, Inc. as owner of the patents was under no obligation to use them. *Hartford-Empire Co.* v. *United States, supra,* at page 432. Furthermore, this position of the District Court is predicated solely upon the decision in *Six-Wheel Corporation* v. *Sterling Motor Truck Co.*, supra. We have already pointed out the distinction between that case and this—in that case the transferee was prohibited by express agreement from manufacturing, using or selling the invention while in this case there is no prohibition or restriction of any kind; the fact that it may not have been intended that Watkins Patents, Inc. manufacture, use or sell the invention did not prohibit it in any way from obtaining that right. Further-

more, the initial intention that Watkins Patents, Inc. not manufacture, use or sell was based upon the idea that Dillman Industries, Inc. was doing that. In two years, however, the latter was out of business and the situation might well have changed so that the parties may then have caused Watkins Patents, Inc. to manufacture. The point is that the original intention did not mean that the parties did not intend that plaintiff transfer complete ownership to Watkins Patents, Inc. so that at some future time it might manufacture.

A further distinction between these two cases emphasizes the essential difference between license and assignment. In the Six-Wheel Corporation Case, the ultimate holding was that the transferee, being only a licensee could not sue an infringer. In this case, that power is expressly given to the transferee. Does this not clearly indicate that our transferee is an assignee?

However, the Six-Wheel Corporation Case is not only distinguishable, it is wrongly decided. In *Standard Oil Co.* v. *Markham*, (D. C., S. D., N. Y.) 64 F. Supp. 656, Judge Wyzanski points out the error and in the case on appeal, *Standard Oil Co.* v. *Clark*, (CA2) 163 F 2d 917; cert. denied, 333 U. S. 873, this Court supported his view at page 929. In his decision, at page 661, Judge Wyzanski states:

> ". . . In this opinion it will be sufficient to deal with the Custodian's main argument that the purported assignments of legal title were ineffective because under the limitations of its own corporate charter and of the Four-Party Agreement S. I. G. could not manufacture under the patents but could use them only to license others.
>
> "This argument of the Custodian is bottomed upon the rulings in *Crown Die & Tool Co.* v. *Nye Tool & Machine Works*, 261 U. S. 24, 36, 43 S. Ct. 254, 67 L. Ed. 516; *Universal Oil Products Co.* v. *Root Refining Co.*, D. C. D. Del., 16 F. Supp. 846, 852, affirmed, 3 Cir., 93 F 2d 186; and *Six-Wheel Corporation* v. *Sterling Motor Truck Co.*, 9

Cir., 50 F 2d 568. From those authorities the Custodian spells out the theory that where a person has not the right to make, use or vend the invention that person cannot be the holder of the legal title to the patent.

"The theory of the Custodian is not in accord with the patent law. Where the patentee assigns to another the exclusive right to make, use and vend the invention but that other by a collateral agreement disables himself from making or using, or vending the invention, or that other grants back to the assignor an exclusive license, there is none the less a valid assignment of title. . . .

"This familiar doctrine of patent law is in no way denied by the Crown Die and Tool case. . . .

"The Universal Oil Products case cited by the Custodian is in reality an authority against him. . . .

"The Six-Wheel Corporation case might perhaps be distinguished on the narrow ground that there the patentee purported to assign the legal title to another 'subject to the condition that said Company (i.e. the assignee) shall not itself manufacture, use or sell any device or devices embodying or containing said invention' (50 F 2d 573). But it is more candid to say that the decision of the Ninth Circuit Court of Appeals is so plainly at variance with the weight of authority that it should be discredited and not distinguished."

We submit that Watkins Patents, Inc. received a valid title to the patents under Exhibit A notwithstanding the parties did not intend it to manufacture, use or sell under those patents but merely to license others to do so.

III

Provisions Constituting Conditions Subsequent Included for the Protection of Plaintiff's Rights to Payment and of the Assignee's Title Do Not Change Exhibit A From An Assignment to A License.

The District Court took another slant—even if Exhibit A did constitute an assignment, too many "legal interests" found their way back to plaintiff. Two, three or four such interests would be all right but the line must be drawn somewhere and this is it. The Court makes no distinction between broad powers and limited powers—for instance in some of the decided cases the right to terminate is extremely broad while in the instant case it is limited to the failure of Watkins Patents, Inc. to borrow from Dillman Industries, Inc. "for the purpose of paying any expenditures incurred by it as needed for patent litigation . . ." We submit that counting legal interests which vary in scope and effect is not the realistic way to deal with liability for tax.

We do not believe that this Court is going to decide the issue in this case on the basis of the number of interests involved but we will point out that there is no way of knowing whether all of the so-called interests present in a particular case have been discussed by the Court in its opinion. In *Commissioner* v. *Celanese Corp*, (CAD of C) 140 F 2d 339, 342 the Court mentions "the various provisions to which we have referred, as well as the others referred to by the Commissioner." Obviously, if a Court regards a provision as unimportant to its decision it may not mention it. In *Pike* v *United States, supra,* the agreement contains the following conditions but they are not all mentioned in the opinion:

(1) Westvaco (assignee) must account and pay royalties;

(2) For five years, Pike (assignor) to act in a consulting capacity for Westvaco without further compensation;

(3) Pike to bear all expenses, costs and damages in infringement suits against Westvaco; if injunction issued Westvaco could cancel;

(4) If Westvaco fails to prosecute infringement action when requested, Pike could take such steps at his own expense as he deemed proper;

(5) Pike may cancel on any breach of any covenant or agreement contained in the agreement, default in payment of any royalty or in making of any report;

(6) Agreement not assignable by Westvaco for period of five years;

(7) Westvaco could cancel on one year's notice.

Let us examine in detail the so-called "legal interests." Obviously, the ownership of a minority interest in Watkins Patents, Inc. is not an interest in the patents. In *Graham* v. *Commissioner*, 26 T. C. No. 90, the assignors owned a majority of the stock in the assignee. The Court considered that fact in determining whether or not a bona fide sale had been made. While the stock ownership is important for that purpose, it does not represent any proprietary interest in the patents.

The provision for payment of royalties does not constitute an interest in the patents nor does it affect the title to the patents. After an assignment has been made, the right to be paid therefor, whether in cash or in instalments, is in no respect a proprietary interest in the patents. In *Watson* v. *United States*, *supra*, at page 691, the Court said:

> "The agreement contained a provision for payment of royalties. That provision merely fixed the compensation to be paid as consideration for the transfer. It did not reserve to Watson any control over the patent or its use. It did not limit or qualify the scope of the grant. . . ."

See also: *Rude* v. *Westcott*, 130 U. S. 152, 163;
Hopkinson v. *Commissioner*, (CA2) 126 F 2d 406.

We have already pointed out that Watkins Patents, Inc. has the right and duty to prosecute and defend infringement suits and the duty to pay the expense of such suits. Plaintiff's right in this respect is limited to continuing the prosecution or defense of such litigation if Watkins Patents, Inc. exhausts its funds and the amount borrowed from Dillman Industries up to $10,000 and then refuses to proceed further. If the litigation is terminated favorably for Watkins Patents, Inc., plaintiff's expenses are to be paid out of the first royalties thereafter collected. This very limited right in connection with infringement suits must be compared with the broader provisions in some of the other assignment agreements. In *Littlefield* v. *Perry*, *supra*, and *Pike* v. *United States*, *supra*, the assignor was required to bear all costs and expenses of litigation and all damages; in *Watson* v. *United States*, *supra*, both assignor and assignee were required to act jointly in resisting infringement; in *First National Bank of Princeton* v. *United States*, (D. C., N. J.) 136 F. Supp. 818, the assignor was required to defend infringement suits brought against the assignee and to save the assignee harmless from any damages recovered in such suits. In all of these cases the rights and duties were held not to affect the transfer of the proprietary interest; certainly, therefore, the much narrower right in the instant case can have no effect.

As already mentioned the power to terminate is limited to the failure of the assignee to borrow from Dillman Industries, Inc. for the purpose of defraying patent litigation expenses. Compare this limited power to those in some of the other agreements. In *Allen* v. *Werner*, (CA5) 190 F 2d 840, the assignor could terminate if the assignee violated the provisions of the agreement "in any way" and the assignee could cancel on 90 days notice; in *Pike* v. *United States*, supra, the assignor could terminate on breach of any covenant in the agreement or default in payment of royalties, if not corrected; and the assignee could cancel on one year's notice; in *Littlefield* v. *Perry*, supra, the agreements contained a provision for forfeiture in the case of nonpayment or neglect to sell the

patented articles to the extent of a reasonable demand therefor. At page 220 of the decision in the Littlefield Case, the Supreme Court said:

> "When the 'grant' was placed on record, Treadwell and Perry became the apparent owners of the entire patent and inventions throughout the specified territory. Neither the agreement to account and pay the royalty nor the clause of forfeiture contained in that instrument reduced them to the position of licensees. The agreement to account and pay formed part of the consideration of the assignment, and was in effect an agreement to pay at a future time a sum to be determined by the number of articles made and sold. For the non-payment or other non-performance a forfeiture might be enforced as for condition broken, but until it was enforced the title granted remained in the assignees."

See, also: *Boesch* v. *Graff*, 133 U. S. 697, 701.

Obviously, these provisions relative to patent infringement were conditions subsequent inserted for the protection of the assignee's title and the assignor's right to realize upon the patents. Normally, the provision for approval of licenses by the assignor is regarded as for the protection of the assignor. However, in the instant case, Mr. Weis explained that the purpose was also to benefit the assignee. The provision in Article VI of Exhibit A is simply: ". . . . the sub-licenses to be approved by said First Party. . . ." With respect to it, Mr. Weis testified on cross-examination:

> "Q. In your examination—direct examination—you indicated that Watkins had the say-so, by that do you mean that Watkins made it clear he wanted to have the power to object to such licenses as you might want to issue? A. No, he knew the people better than we did. He knew whether we should issue the license or not—we didn't want to have too many licenses in a territory—that would have a tendency to cause price cutting and friction with our licensees. We wanted licenses but we wanted to distribute them in a territory that

could consume them without cutting each others throats. We just let Mr. Watkins sort of figure that out." (App. p. 15).

In *Rollman* v. *Commissioner, supra*, the Court says:

". . . The authorities do not support the view that the grant of exclusive rights under a patent does not amount to a transfer of a capital asset if the assignee cannot grant a sub-license without the assignor's consent. Such a limitation does not interfere with the full use of the patent by the assignee and it serves to protect both parties to the assignment in case the purchase price is paid in instalments. . . ."

See also: *Platt* v. *Fire Extinguisher Mfg. Co.*, (CA3) 59 F. 897, 901.

The similar provision that the license was non-transferable was considered in *Watson* v. *United States*, supra, at page 691:

"The contract contained a further provision that the rights of the licensee thereunder should not be assigned without the consent of the licensor having been obtained in writing. That precautionary provision was intended to protect the rights of the parties under the contract, not to proscribe, limit, or nullify their intent and purpose to vest immediately in the transferee the right to manufacture, sell and use the carts throughout the life of the patent, as well as any extension or extensions thereof. . . ."

See also: *Allen* v. *Werner*, supra, 842;

First National Bank of Princeton v. *United States*, supra, 823;

Crook v. *United States*, (D. C. W. D. Penn.) 135 F. Supp. 242, 252.

Exhibit E is a license from Watkins Patents, Inc. to plaintiff. By its terms plaintiff could not use it so long as he was employed by Dillman Industries, Inc. under Exhibit C. If, however, he left that employ, which he could do after June 30, 1941, he could associate with others in manufacturing under this license; if this

association terminated, the former associates of plaintiff would be entitled to obtain a standard license from Watkins Patents, Inc. The District Court was much concerned with what the plaintiff might do under this provision although it knew that the plaintiff had never even used the license himself and had been in the employ of Watkins Patents, Inc. since Diliman Industries, Inc. went out of business in 1942. (Tr. p. 50). However, the broadest effect of the provision is to construe it as terminating the exclusive character of the right transferred to Watkins Patents, Inc. This provision is obviously a condition subsequent since it could by no means be effective until June 30, 1941, more than one year after the date of the agreements. The consideration of a similar provision in *Watson* v. *United States*, supra, at page 691, is relevant:

> "The agreement contained a provision relating to the termination of its exclusive character. The substance of the provision was that, in the event the corporation should after one year from the date of the agreement fail to make and sell 2,500 carts during any six-months period, the licensor should be free to license others to manufacture and sell carts. But that provision concerned itself exclusively with a condition subsequent. It did no more than provide that upon the occurence of a stated event the grantor was empowered to terminate the exclusive right and title theretofore conveyed. It did not detract from the effectiveness of the agreement as constituting an assignment of patent rights. . . ."

Of course, the granting of the license back to plaintiff, while very strongly evidential that the parties intended to vest complete title to the patents in Watkins Patents, Inc., had no effect upon the transfer of that title. See *Littlefield* v. *Perry*, *supra*, p. 220.

We submit that the presence of these conditions subsequent have no effect upon the transfer of title to Watkins Patents, Inc. so

long as the conditions were not broken. As stated in *Platt* v. *Fire Extinguisher Mfg. Co., supra,* at page 901:

> ". . . The title was conveyed to the complainant subject only to certain conditions, and the assignor had no more right to it than a stranger, so long as the conditions should remain unbroken. If the complainant should fail to keep his covenants, then the conditions would be broken. and the property would revert to Graham. Until this event happens the complainant has the right to protect his interests by suing infringers of the patent. . . ."

See also: *Littlefield* v. *Perry, supra,* 220;
Boesch v. *Graff, supra,* 701.

CONCLUSION

The decision of the District Court is erroneous and should be reversed.

Respectfully submitted,

CURTISS K. THOMPSON,
JOHN H. WEIR

August, 1957

APPENDIX

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UNITED STATES DISTRICT COURT

District of Connecticut

JAMES R. WATKINS AND LUCILE L. WATKINS,
Plaintiffs

vs.

UNITED STATES OF AMERICA,
Defendant.

Civil Action No. 5052

DOCKET ENTRIES

August 20, 1954

Complaint filed—Summons issued.

August 25, 1954

Marshal's return showing service, filed—summons.

October 22, 1954

Stipulation extending time to answer or plead, filed.

December 23, 1954

Answer filed.

March 8, 1956

Pre-trial Order entered. Smith, J. Copies mailed counsel.

June 26, 1956

Motion of defendant for leave to file amended answer and Notice of motion filed.

July 2, 1956

Hearing on motion of defendant for leave to file amended answer. Motion granted. Anderson, J.

July 12, 1956

Motion for judgment on the pleadings filed (by plaintiffs) together with Notice of motion.

December 7, 1956

Notice of taking deposition of W. Emery Lancaster and A. W. D. Weis filed.

December 17, 1956

Depositions of A. W. D. Weis and W. Emery Lancaster filed.

December 21, 1956

Court trial commences—two witnesses for plaintiffs sworn and testified. Plaintiffs' Exhibits A, B, C, D, E and F admitted into evidence. One witness for defendant testified (a plaintiff witness called by defendant as its own). Both parties rest. Plaintiffs to file briefs by noon on January 11, 1957. Defendant to mail its brief to Judge Anderson at Noank by January 31. Plaintiffs to file reply by February 8, 1957. Anderson, J.

February 14, 1957

Court Reporter's notes filed.

March 12, 1957

Findings of Fact, Conclusion of Law and Discussion filed and entered. Anderson, J. Copies mailed counsel. Judgment with costs may enter in favor of the defendant.

March 12, 1957

Judgment entered dismissing action on merits, defendant to recover costs. Earl, C. Copies mailed counsel.

March 20, 1957

Taxation of Costs entered. Earl, C.

March 22, 1957

Motion for extension of time for filing motion to amend findings and make additional findings filed. Motion granted. Anderson, J.

April 10, 1957

Notice of Appeal filed by plaintiffs. Copies mailed U. S. Attorney. $250 received as appeal bond.

TESTIMONY AT TRIAL

Kennett Wade Dillman, being duly sworn, testified as follows:

Questions by Mr. Weir

* * * *

Q. During the period from 1937 to early 1940, did you have any conversations with Mr. Watkins with reference to a change in the license agreement between him and Dillman Industries? A. Yes. There was quite a few—a few conversations, because we were trying to develop the manufacture of the container and expand the sale of it. And we were interested to the extent that we thought it could be greatly expanded but it would have to be done through other means than just Dillman Industries. We would have to make some other arrangements to do it.

Q. Had Dillman Industries attempted to exploit the use of the license while it had its own license? I will withdraw that question. What had Dillman Industries done, during the period that it had its license, to increase the use of the box? A. Well, we had Mr. Watkins out trying to make sales, and get the box generally accepted on the market. And on my end of the line at the plant, I had spent a lot of time and we of course had spent a lot of money on trying to make the box, to get it set up where it could be made on an efficient mass-production basis. And this we discussed with Mr. Watkins. He was anxious to get the box more generally accepted across the country, and the only way that could be done would be to license others to do it.

Q. Had Mr. Watkins licensed others? A. There had been, I think, one or two other licenses, yes, sir.

Q. What was the purpose of these conversations between you and Mr. Watkins with reference to a new arrangement between Dillman Industries and Mr. Watkins? A. Well, Mr. Watkins talked to myself and to Mr. Weiss from time to time stating what his ideas were with reference to expanding the use of the Watkins

box and licensing others to make it. And we told Mr. Watkins—I say we—and in conversation, Mr. Weiss and myself with Mr. Watkins, that we wanted to do that, too. But we were not willing to go ahead with this thing unless we could have the complete ownership of it, because we realized we were going to have to spend an awful lot of money. When we finally did go ahead, we spent over $50,000 on one experimental machine.

(Tr. pp. 13, 14)

* * * *

Question by the Court

Q. You say that you wanted something more than a license. You wanted to own the patent; is that it? A. That is right. If we were going to go ahead and put more money in it and expand this operation, yes, sir. (Tr p. 15)

* * * *

Questions by Mr. Weir

Q. You tell us, or tell the Court if you will, what you remember as to what Mr. Watkins said or you said or what Mr. Weiss said with respect to the making of a new arrangement regarding these patents. A. Well, Mr. Watkins said that he wanted to expand the use of the patents and he realized to do it would take considerable amount of financing or money, which he didn't have. And I stated to Mr. Watkins that I was in agreement with him with the idea of expanding this, and I thought we could work it out, although I didn't think it was proper to be done by Dillman Industries as a corporation. And Mr. Weiss stated that he was willing to go along with it and to have Dillman Industries provide the financing for it, but only so long—we told Mr. Watkins very definitely at that time—that only so long as we had ownership of the patents. (Tr. p. 17)

* * * *

Q. During the course of these conversations between Mr. Watkins, yourself and Mr. Weiss, was anything said about a license from Watkins Patents to Mr. Watkins? A. Yes.

Q. What was said on that point? A. Well, Mr. Watkins made it a part of his deal—in other words, in assigning these patents to Watkins Patents, he insisted that he have a license from Watkins Patents to protect his interests. In other words, he might be let out by Dillman Industries and there he would be, without any patents, without anything. And so that was a consideration in transferring the ownership from himself to Watkins Patents, that he in turn received a license that he might use at any time, anywhere.

Q. From Watkins Patents? A. From Watkins Patents, yes, sir. (Tr. pp. 20, 21)

* * * *

Q. Was anything said during the course of these conversations about the license that was in existence from Mr. Watkins to Dillman Industries? A. Yes. That came up.

Q. What was said by the parties? A. Well, Dillman Industries stated that they would want a license from the new company because, although they had a license from J. R. Watkins, they wanted a license from Watkins Patents, Incorporated. And that was arranged. (Tr. pp. 21, 22)

* * * *

Q. Now, as a result of these conversations, were any agreements drawn up? A. Yes.

Q. Who prepared the agreements? A. Attorney Lancaster.

Q. His full name is W. Emory Lancaster; is that correct? A. That is correct.

Q. Where was his office located? A. Quincy, Illinois.

Q. Do you know for whom he was acting as attorney? A. He was acting as attorney for Dillman Industries.

Q. Do you know what he was told as to the agreement of the parties with respect to this new arrangement? A. Yes, sir. He was instructed to prepare these agreements between Mr. Watkins and Dillman Industries. And he was told and instructed that Mr. Watkins was transferring the patents from his own personal ownership to Watkins Patents and that we had agreed on the various points. And he was instructed to go ahead and prepare the agreement. (Tr. pp. 22, 23)

* * * *

Q. Do you know whether or not Watkins Patents, Incorporated set up a fund to take care of patent infringement litigation? A. We did.

Q. Do you know whether or not the creation of such a fund was discussed by you and Mr. Watkins and Mr. Weiss at the time of the discussions you have testified to? A. Yes, sir, it was.

Q. What was said by the various parties about that? A. Well, Mr. Watkins stated that he did not have the necessary finances to fight or to defend any infringement suit, and he wanted Dillman Industries or Watkins Patents to establish that fund so that it could be offered as a protection.

Q. And we stated that we would. On his assigning patents to Watkins Patents, we would establish that fund. We agreed to do it. (Tr. p. 29)

* * * *

Q. Now, following the signature of these agreements and the organization of Watkins Patents, were there any discussions between the officers of Watkins Patents as to the licensing of particular persons or individuals, do you recall? A. Yes, sir. There was quite a few of them. (Tr. p. 30)

* * * *

Q. Between whom did these discussions take place? A. Between Mr. Weiss and Mr. Watkins and myself.

Q. What was said by these various persons during the discussions? A. Well, they were mainly—came about in the fact that one of us would propose somebody—an individual or company, as a prospective licensee, or would present it, if the person had applied for a license. And the three of us would discuss as to whether or not we—if I proposed it, Mr. Weiss and Mr. Watkins would discuss it, as to whether or not the proposal was acceptable, or not. They often became quite heated.

Q. During those discussions was anything said about ownership of these patents? A. Well, you have already met Mr. Weiss and you know him, and he had become quite excited. He, many times, would call the attention to both Mr. Watkins and myself by shaking his finger and saying, "We own this patent. You don't have a damn thing to do with it now."

Q. What would Mr. Watkins say to that? A. He wouldn't say anything. That usually ended the argument right there.

(Tr. pp. 31, 32)

* * * *

Question by Mr. Gitelman

Q. At that time Dillman Industries was making boxes; is that correct? A. We were making various types of boxes.

Q. Yes. And then you decided that you would create a new organization whose purpose it would be to handle the sub-licensing of the Watkins' patents? A. Well, we created the new corporation so that it could handle the licensing end of it. We didn't want that involved in Dillman Industries.

Q. That is, the Watkins Patents, Incorporated sole job was to handle the sub-licensing? A. It was to handle the licensing of licensees.

Mr. Weir. I object to that, your Honor. I don't recall any testimony to that effect.

The Court. Well, obviously it would include the interest in the patents, the holding of the interest in the patent. Is that the objection?

Mr. WEIR. Well, that is the objection. I think he used the word "sole."

The COURT. He said "solely." By that you didn't mean, I take it, to exclude the patents because they couldn't very well grant licenses if they didn't have any interest in the patents?

Mr. GITELMAN. No. What I am driving at is that Watkins Patents, Inc. was not created to manufacture boxes.

A. No, we didn't.

* * * *

Question by the Court

Q. Do you, Mr. Dillman, mean that all that Watkins gave to Watkins Patents, Incorporated, or transferred to them, was an exclusive non-transferable right, but that ownership was retained by Watkins? A. That was not my understanding of it, no. In other words, I understood that we owned the licenses; in other words, that they were assigned to us. I don't know about the terminology here but— (Tr. p. 41)

* * * *

Question by Mr. Gitelman

Q. In other words, it was your understanding that that 1941 patent passed immediately to Watkins Patents Incorporated under this agreement? A. That was my understanding, that anything, any and all patents that he might obtain in the future, would be assigned to Watkins Patents.

Q. By "assigned" do you mean "would immediately pass on to" Watkins Patents under the basic agreement? There would be no need for any further agreement. A. No. He was to turn over everything to Watkins Patents and we were to pay the bills. (Tr. pp. 43, 44)

* * * *

James R. Watkins, being duly sworn, testified as follows:

Questions by Mr. Weir

* * * *

Q. What were the purposes of these conversations with the two Dillmans and Mr. Weiss? A. Well, I realized at the time that I could not—I didn't have the finances to protect the patents against infringement. And I also realized that I could not in the time that I had to sell the container, to promote it—that I could not take advantage of the prospects for selling the container. I couldn't cover the field. So I entered into conversation about them taking over and buying these patents so that some arrangements, through the finances which they did have—I would have protection and that others would be licensed to manufacture.

Q. At this time was Dillman Industries a successful corporation, do you know? A. Yes. They were successful and they had a new plant there which impressed me, that they were progressive. I thought they would do a good job promoting.

Q. In the latter part of '39 and the early part of 1940, did you have some conversations on this subject with Mr. Weiss and Mr. Dillman? A. Yes.

Q. Will you kindly tell the Court what was said by you, by Mr. Weiss and by Mr. Dillman during the course of these conversations concerning a new arrangement with respect to the patents? A. Well, I believed at that time, and it proved later, that Mr. Weiss who was a man of considerable means financially—he was well known in the industry. So I approached first Mr. Dillman because I had met him when I first left college and knew he had this manufacturing plant, with the idea of getting them to make this container. Dillman referred me to Weiss who was financial backer of Dillman Industries. So with that background I felt secure in approaching Mr. Weiss with the understanding that his company, or he, buy these patents and promote them. Well, he said that they were interested in it. They were manufacturers at

that time principally of egg cases and meat boxes. And that business was deteriorating to some extent. And they wanted something additional to come into their plant. So he was open to suggestion there that they become interested in this container. And he said he would. He would consider and he would talk it over with Frank Dillman. So after a while, possibly a couple of months or so, the question came up some more. And they said that they would purchase these patents and they—in the course of events, as we talked about what I wanted for them, I asked him—told him that I wanted certainly what I had paid the patent lawyer for developing them and that I wanted to participate in the earnings of the containers which were manufactured under the patent. Then—Mr. Weiss then said that in his opinion this new company should be organized to take over the patents and promote them separate from Dillman Industries itself. And that led up to the point where I, after considerable conversation, led up to the point where they agreed to pay me for the patents, and led up to this agreement which Mr. Lancaster drew up.

(Tr. pp. 51, 52, 53, 54)

* * * *

Q. These agreements—they were executed in April 1940—covered all of the patents which you then owned; is that so? A. That is right.

Q. Was a new patent issued to you subsequent to the execution of these agreements? A. Yes. There was a patent issued about '41 or so.

Q. Do the licenses issued by Watkins Patents include rights under the patent issued in 1941? A. Yes.

Q. In other words, the licensees from Watkins Patents operate under all of the patents that have been issued to you? A. Yes. It is my understanding that any new container or patent I receive on a combination corrugated and wood fibre container becomes a part of this agreement.

Q. When the patent was issued to you in 1941, did you execute any document transferring it to Watkins Patents, Incorporated? A. I don't recall that I did. I just turned the patent over to Watkins Patents at one of the meetings, and that is all I did about it. (Tr. pp. 56, 57)

* * * *

Q. In connection with this patent issued in 1941, you made the application in your own name, did you not? A. Yes, that is right.

Q. Did you pay the expenses of that application? A. No. I never paid any. After this patent, Watkins Patents, Incorporated was organized—I never paid any expense—lawyers or traveling or any other expense, in connection with obtaining patents.

Q. Who paid those expenses? A. Watkins Patents, Incorporated.

Q. Have you made any application for patents since 1941? A. Yes. There is a patent pending now.

Q. Did you pay any of the expenses in connection with that application? A. No, no.

Q. Who paid those expenses? A. Watkins Patents, Incorporated. (Tr. pp. 57, 58)

EXHIBIT F

A. W. D. Weis, being duly sworn, testified as follows:

Questions by Mr. Weir

* * * *

Q. While Mr. Watkins was in the employ of Dillman Industries, did you have any conversations with him about those patents? A. Sure we did. I couldn't identify any particular conversation but he was in our employ and we talked about the patents right along.

Q. Was there any conversation about a new arrangement under the patents? A. Yes, before we made this contract here.

Q. Do you recall any specific conversations? A. No, I don't.

Q. Do you recall where the conversations were held? A. There was a desire for a wider distribution of the Watkins patents—can I tell this my own way then I'll get it straight—we were making that territory over there and there were some other parties—we were stepping on their toes—the contracts they had. They wanted a license—all right, we objected to some of the licenses for the reason that we were supplying them. We worked up the business. We didn't think it was right for him to put in other licenses. From the ramification just came the idea we better get together and have control of the patents and we would know how to handle it, and list the patents through anybody we wanted to—Watkins had the say so—if he said "No," we couldn't do it.

Q. As a result of these conversations, was a new corporation formed? A. Yes.

Q. What was the name of the new corporation? A. Watkins Patents, Inc. (Tr. pp. 80, 81)

* * * *

Q. As a result of those conversations, did you instruct Mr. Lancaster to prepare these agreements? A. We came up and talked and made notations, had some tentative contracts which we corrected and had to re-write them till we got what we wanted. We wanted what Watkins wanted. It wasn't really an easy contract to draft, to tell you the truth about it. Watkins was selling something, we were buying something. (Tr. p. 83)

* * * *

Q. When you signed those agreements in behalf of Watkins Patents, what were your intentions with respect to the ownership of those patents? A. For the life of the patents and any improvements thereon, we would have them.

Q. By "we" you mean Watkins Patents? A. Yes.

(Tr. p. 84)

* * * *

Questions by Mr. Gitelman

Q. In your examination—direct examination—you indicated that Watkins had the say-so, by that do you mean that Watkins made it clear he wanted to have the power to object to such licenses as you might want to issue? A. No, he knew the people better than we did. He knew whether we should issue the license or not—we didn't want to have too many licenses in a territory—that we would have a tendency to cause price cutting and friction with our licenses. We wanted licenses, but we wanted to distribute them in a territory that could consume them without cutting each others throats. We just let Mr. Watkins sort of figure that out. (Tr. p. 85)

* * * *

Q. Did Watkins Patents, Inc., ever get into any ligation on patent infringements? A. No, we had a fund set aside, but we never had to use it. In fact I think the original contract provides for that. We complied with that. (Tr. p. 87)

* * * *

EXHIBIT F

W. Emery Lancaster, being duly sworn, testified as follows:

Questions by Mr. Weir

Q. What is your present occupation? A. I am an attorney.

Q. You are admitted to practice in the State of Illinois? A. I have been practicing in the State of Illinois for fifty years. I have a certificate on the wall over there. (Tr. p. 88)

* * * *

Q. As a result of these discussions you prepared certain agreements? A. They gave me facts and I prepared agreements.

Q. What did they tell you? A. It seemed that the Dillman Industries had a license, under a patent with Watkins in 1937, in

fact I made a memo of it and in 1940 the idea was to sell the patents, I think there were four if I remember rightly, to this new corporation, Watkins Patents, Inc., that is in 1940 and this was done. Papers were drawn accordingly and after it was done I think the provisions provided that the license which Dillman had enjoyed from Watkins was cancelled and a new license was issued to Dillman from the Watkins Patents, Inc. There were many things that entered into the contract, if you want to ask more specific questions. (Tr. pp. 88, 89)

* * * *

FINDINGS OF FACT

(Caption omitted) (Tr. pp. 149-163)

1. On April 17, 1934 there was issued to the plaintiff, James R. Watkins, U. S. Letters Patent No. 1,955,107 covering a wood cleated corrugated shipping container.

2. Subsequently, additional Letters Patent were issued to him for improvements on the shipping container as follows:

October 9, 1934, Letters Patent No. 1,976,693;
December 27, 1938, Letters Patent No. 2,141,497; and
May 13, 1939, Letters Patent No. 2,159,642

3. In March 1937 the plaintiff, James R. Watkins, entered the employ of Dillman Industries, Inc. of Caruthersville, Missouri, manufacturers of lumber, wooden boxes and crates, and at that time entered into an agreement with Dillman Industries, Inc. whereby Watkins granted to the corporation a non-exclusive license to manufacture containers under the patents which, up to that time, had been issued to him.

4. The manufacturing and sales of the shipping containers proved to be successful and early in 1940, after the last two patents relating to the shipping container had been issued to Watkins, negotiations went on between James R. Watkins and some of the

officers and leading shareholders of Dillman Industries, Inc. acting both on behalf of the corporation and themselves personally, relative to new agreements for the exploitation of the patents.

5. During said period a new corporation, Watkins Patents, Inc., was organized under the laws of the State of Illinois in which the plaintiff, James R. Watkins, owned twenty per cent of the shares issued and outstanding and the remaining eighty per cent of said shares were owned by Dillman Industries, Inc. or officers and shareholders of Dillman Industries, Inc.

6. On April 17, 1940 the four patents above referred to were the subject of five agreements entered into, eodem instante, which may generally be summarized as follows:

(a) An agreement between James R. Watkins and Watkins Patents, Inc. by which Watkins transferred to Watkins Patents, Inc. a non-transferable exclusive license for the use of and sub-licensing under the patents. By the same agreement Watkins Patents, Inc. agreed to pay Watkins $3,600 in cash and twenty per cent of the stock in Watkins Patents, Inc. and one-third of the net royalties derived from licensed manufacture under the patents, subject to certain minor qualifications. Said contract provided further that Watkins had a non-transferable, non-exclusive sub-license under the patents, and that anyone with whom he became associated to practice his sub-license had a right to sub-license from Watkins Patents, Inc. even after the termination of the association between Watkins and such individual, co-partnership or corporation. Said agreement further provided that in the event of litigation concerning said patents, or any of them, Watkins Patents, Inc. had a duty to defray the cost of such litigation up to the amount of $10,000 and that with regard to expenditures above said amount Watkins Patents, Inc. had the option of paying the additional amount necessary or to refuse to do so, in which event said James R. Watkins had the right to carry on such litigation at his own expense with certain provisions for reimburse-

ment in the event of his successful prosecution or defense of said litigation. Said contract further provided that sub-licenses of Watkins Patents, Inc. were subject to the approval of James R. Watkins and that all existing licenses were transferred to Watkins Patents, Inc. by James R. Watkins. The contract also provided that Watkins Patents, Inc. had a duty to account to Watkins and that copies of the contract and assignments of prior licenses should be in proper form for filing in the U. S. Patent Office.

(b) An agreement between Watkins Patents, Inc. and Dillman Industries, Inc. by which Dillman Industries received a non-transferable, non-exclusive license to manufacture and sell containers under the patents of Watkins Patents, Inc. in return for its payment to Watkins Patents, Inc. of royalties of one per cent of the net sales of containers sold under the license, such royalties to become one and one-half per cent in case the employment of James R. Watkins by Dillman Industries, Inc. was terminated.

(c) An agreement between Dillman Industries, Inc. and James R. Watkins by which a license previously granted to Dillman Industries, Inc. by Watkins was canceled. This agreement provided further that Watkins' employment contract with Dillman Industries, Inc. was terminated and a new employment contract entered into, under the terms of which Dillman Industries, Inc. was to pay Watkins $400 per month and twenty-five per cent of Dillman Industries' net income from the manufacture and sale of products under Watkins Patents. At the end of any year either party could terminate the employment contract by giving notice. The agreement also contained certain provisions concerning the holding by Watkins of stock in Dillman Industries, Inc.

(d) An agreement between James R. Watkins, Dillman Industries, Inc. and Watkins Patents, Inc. which incorporated agreement (a) above, canceled a previous license given by Watkins to Dillman Industries, Inc. and provided for the execution of a sub-license to Dillman Industries, Inc. from Watkins Patents,

Inc. (agreement (b) above). The agreement contained certain other provisions, including Dillman Industries' promise to loan Watkins Patents, Inc. certain amounts for the purpose of paying litigation expenses that might arise in defense of Watkins' patents.

(e) An agreement between Watkins Patents, Inc. and James R. Watkins by which Watkins Patents, Inc. purported to grant James R. Watkins a non-transferable, non-exclusive license to manufacture and sell containers under the Watkins Patents in return for royalty payments of one and one-half per cent of the net sales of such containers. The agreement further provided that said license was not to be used by James R. Watkins as long as he was employed by Dillman Industries, Inc.; but that upon leaving the employment of Dillman Industries, Inc., (which at his option he might do at the end of any year) he might operate under the license, or if he became associated with any individual, co-partnership or corporation, such enterprise might manufacture and sell under his license. The agreement provided that upon termination of Watkins' association with any such individual, co-partnership or corporation, such individual, co-partnership or corporation would have the right to obtain a license from Watkins Patents, Inc. The agreement expressly provided that Watkins, upon termination of such associations, might continue to use his license individually or enter into subsequent associations, one at a time, with other individuals, co-partnerships or corporations, which could use his license during the period of association and obtain a license from Watkins Patents, Inc. upon termination of the association.

7. The agreement between James R. Watkins and Watkins Patents, Inc. did not transfer from James R. Watkins to the corporation, nor did the parties intend that it should transfer, all the substantial rights to the patents.

Conclusions of Law

1. This court has jurisdiction of the subject matter and of the parties in this action.

2. The agreement between James R. Watkins and Watkins Patents, Inc. did not constitute a sale or assignment of the patents but was only the grant of a license.

3. The income reported by the plaintiffs in their 1949 through 1952 returns and derived from the licensing by James R. Watkins of Watkins Patents, Inc. was ordinary income and not capital gains.

Discussion

The question presented is whether the items of income received by the plaintiffs for the years 1949 through 1952 and derived from agreements with Watkins Patents, Inc. concerning Watkins' patents were ordinary income as set out in the tax returns which they filed for those years, or were actually capital gains from a sale of assets held for more than six months under Sec. 117(a) Internal Revenue Code of 1939 as to the calendar years 1949 and 1950, and Sec. 117(q) Internal Revenue Code of 1939 as to the calendar years 1951 and 1952. The plaintiffs assert that they were capital gains and in this action they are suing for a refund.

It was stipulated by the parties at the trial that testimony might be received from the plaintiffs, relative to the history of the parties to the contracts referred to in the finding, the business relationship of the parties and the negotiations before and during the making of the agreements as well as some testimony as to what the parties to the contracts actually did pursuant to them. This was received with the understanding that the court, after hearing all of the evidence and arguments in the case, would rule upon the defendant's objection that such parol testimony was inadmissible

as an effort to vary the terms of the written contract. That objection is overruled and the subsequent motion by the defendant to strike is denied.

It is the Government's claim that what the patentee, Watkins, transferred to Watkins Patents, Inc., was a mere license rather than an assignment or sale of the patents. It relies upon that part of the opinion in *Waterman* v. *Mackenzie*, 138 U. S. 252 at pages 255 and 256 which in effect says that the grant of anything less than the "right to make and the right to use and the right to sell" is not an assignment or sale of a patent. See *Broderick* v. *Neale*, 201 F. 2d 621 (Tenth Cir.). While the plaintiffs are correct in pointing out that there is no absolute requirement that the precise language of this trilogy be used or that exact synonyms for "make," "use" and "sell" be set out in the agreement of transfer, nevertheless, the agreement must in the language it employs in the context of the case convey all substantial rights to the patent, and the language used must be broad enough for this purpose. The plaintiffs claim that the wording used by James R. Watkins in the agreement with Watkins Patents, Inc. "does hereby transfer and grant . . . the non-transferable exclusive license for the use of and sub-licensing under each and all . . . the patents" is sufficient. Under certain circumstances and in certain contexts such as imprecise expression of assignment or sale could be so construed. *Reid* v. *Commissioner*, 26 T. C. 78; *Associated Patentees Inc.* v. *Commissioner*, 4 T. C. 979; *Daily* v. *Universal Oil Products Co.*, 76 F. Supp. 349 (D. Ill.); and *Pike* v. *U. S.*, 101 F. Supp. 100 (D. Conn.). These and other cases also state that the use of the word "license" instead of the words "assign" or "sell" is not in itself conclusive. It is, however, something which may be considered with the other facts and circumstances of the case to determine what the operative intent of the parties was. *E. W. Bliss Co.* v. *U. S.*, 253 U. S. 187. *In Switzer* v. *Commissioner of Internal Revenue*, 226 F. 2d 329 (Sixth Cir).

at page 330 the court, after citing *Waterman* v. *Mackenzie*, supra, and two Sixth Circuit cases said:

> ". . . Those cases also point out that whether the instrument constitutes an assignment or a license does not depend upon the name by which it is called, but upon the legal effect of its provisions.
>
> "However, it is also the rule that while such words in a license agreement give rise to an assignment of a patent where the document granting such a license is consistent with a present intention by the owner to transfer the patent, they can not be held the equivalent of an assignment where the document itself and the total factual complex surrounding the transaction negatives such a transfer. Although no particular form is required for an assignment, the instrument of transfer must be unambiguous and show a clear and unmistakable intent to part with the patent. . . ."

In the present case five written agreements were executed and delivered at the same time and they must all be construed together. What the parties intended by a particular phrase or provision in the agreements must be found from the language itself, its context in the written instrument of which it is a part and the other four agreements, all considered against the background of the surrounding circumstances. Such a study makes it apparent that what was transferred by Watkins to Watkins Patents, Inc. was the power to license or, as the court described it in *Six Wheel Corporation* v. *Sterling Motor Truck Co.*, 50 F. 2d. 568 (Ninth Cir.) at 573, "the license to license."

Looking at the facts of the case in their broadest aspect, James Watkins owned certain patents in connection with which there was promise of considerable demand from various manufacturers for licenses from which profitable royalties could be realized. To promote the dissemination of licenses, to provide for means to protect the patents in infringement actions, and to establish offices to handle the business of the licenses, royalty accountings, etc.,

required money which Watkins did not have. Dillman Industries, Inc. already had, and for some time had used, a license to manufacure and sell Watkins' patented container, and Watkins had an employment contract with Dillman Industries, Inc. The individuals who owned controlling interests in Dillman Industries, Inc. had the necessary capital to promote the licensing under Watkins Patents and saw an opportunity to make a profit in doing so in a field with which they were familiar. To limit the responsibilities of themselves and Dillman Industries, they agreed with Watkins on the organization of Watkins Patents, Inc. through which the financing and promotion of licensing would be carried on. The power to license with the incidental protective right to conduct or participate in infringement actions, and the rights in outstanding licenses were the only incidents of ownership which any of the parties intended to have conveyed and were in fact the only interests conveyed by James R. Watkins to Watkins Patents, Inc. This purpose and intention is clearly expressed in the agreement between James R. Watkins, Party of the First Part, Dillman Industries, Inc., Party of the Second Part and Watkins Patents, Inc., Party of the Third Part, where it says:

> "First Party is desirous of having a wider and more general use of, and more extensive manufacture of containers covered by his patents, and to accomplish this has approached and proposed to Second Party that Second Party enter into a contract with him for the exclusive handling of his patents by means of licensing various individuals and firms throughout the United States of America to manufacture crates under the above referred to patents owned by First Party.
>
> "Second Party realizes and sees the advantage of such an arrangement and has caused to be organized under the laws of the State of Illinois a corporation, Party of the Third Part under this agreement, known and designated as Watkins Patents, Inc. . . ."

Where the granting clause of the Watkins—Watkins Patents, Inc. agreement says " . . . license for the use of and sub-

licensing under," it is also clear from its context, the surrounding circumstances and the witnesses' testimony, particularly Mr. Dillman's, that "use" meant the exploitation of the patents by issuing licenses. Its meaning was intended by the parties to be limited to this alone; it did not intend a conveyance of all of the substantial rights in the patents, and it did not mean or include either the right to manufacture or the right to sell or the right to use the product. In his testimony Mr. Dillman said, "He (Mr. Watkins) was anxious to get the box more generally accepted across the country and the only way that could be done would be to license others to do it. . . . Mr. Watkins talked to myself and Mr. Weiss from time to time stating what his ideas were with reference to expanding the use of the Watkins box and licensing others to make it. . . . We created the new corporation so that it could handle the licensing end of it." In response to a proper question on cross-examination, "That is, the Watkins Patent, Inc. sole job was to handle the sub-licensing?" he replied "It was to handle the licensing of licensees."

The plaintiffs' witnesses in their testimony frequently talk of the transfer by Watkins to Watkins Patents, Inc. of "complete ownership" or "ownership" of the patents and that the controlling interests in Dillman Industries would not have entered into financing Watkins Patents, Inc. without such complete ownership. It is significant, however, that neither any such words nor their legal equivalents were used in the lengthy written agreements drafted by their counsel; and the claim must be rejected. The individuals financing Watkins Patents, Inc. sought and received for Watkins Patents, Inc., which they controlled, only the power, exclusive (except for what was kept in the hands of Watkins), to grant licenses under the patents and to have the right to royalties flowing from the licenses issued. Their interest was financial; and to protect their investment and insure their prospects for profit, they neither sought nor needed to have Watkins Patents, Inc. vested with the rights to manufacture or sell or use the

products of the patents or any rights other than the legal interests conveyed to Watkins Patents, Inc., i.e., the power to license and the right to a share in the royalties.

The question in this case may be approached in another way. Even if it is assumed, as plaintiffs claim, that all the legal relations which go to make up ownership of the patents were transferred in the granting clause in the agreement between James R. Watkins and Watkins Patents, Inc., many legal interests out of the whole bundle of legal interests which constitute ownership found their way back into the hands of James R. Watkins as a result of the whole transaction set out in the five agreements. The question, therefore, may be put in this fashion: For income tax purposes what legal interests may still remain in the hands of the patentee who purports to sell his patents to another without reducing that sale to a grant of a license?

After the agreements became operative, Watkins had an employment contract with Dillman Industries, Inc. which after one year he could terminate at will. Upon such termination he had a license to practice the patents and the power to require Watkins Patents, Inc. to license any individual, co-partner or corporation with whom Watkins had associated himself for manufacturing and selling the products and from whom Watkins had dissociated himself; and Watkins had the power to disseminate licenses in this manner by making and breaking such associations without limit. Watkins had a veto power in the requirement of his approval of any licenses granted by Watkins Patents, Inc. He was a substantial though minority shareholder of Watkins Patents, Inc. He could compel Watkins Patents, Inc. to finance infringement litigation up to $10,000 in cost and above that amount, if the corporation did not choose to do so, he had either to bear the responsibility himself with right of reimbursement only if he were successful or withdrew from the actions. The legal interest granted by Watkins to Watkins Patents, Inc. was non-transferable. Watkins was to be paid in part by a share in royalties;

and a default by the other parties in certain obligations under the agreements would work a termination of their interests in the patents and a return of those interests to Watkins.

Thus, while James R. Watkins transferred with his right hand a bundle of legal interests which he claims constituted complete ownership, he took back with his left hand a substantial number of those interests. Because of the special status of patents and the favorable attitude of Congress toward inventors, the courts, in construing agreements in the course of determining tax liability, have permitted inventors to retain some legal interests in the nature of safeguards for royalty payments and to prevent the shelving or misuse of patents. *Koe* v. *U. S.*, 138 F. Supp. 567 (S. D. Texas) at 570, and *Kronner* v. *U. S.*, 110 F. Supp. 730, 734 (U. S. Court of Claims).

An assigning patentee may have an interest in or be employed by a corporate assignee, *Hofferbert* v. *Briggs*, 178 F. 2d 743 (Fourth Cir.); and the purchase price for the patents may be paid in royalties. *Watson, et al.* v. *U. S.*, 222 F. 2d 689 (Tenth Cir.); *First National Bank of Princeton* v. *U. S.*, 136 F. Supp. 151, 822 (D. N. J.). See: *Block* v. *U. S.*, 200 F. 2d 63 (Second Cir.) 1952; Title 26 U. S. C. Sec. 1235. He may reserve to himself or have the assignee transfer to him a license to practice the patent. *Kavanagh* v. *Evans*, 188 F. 2d 234 (Sixth Cir.); *Crook* v. *U. S.*, 135 F. Supp. 242, 253 (W. D. Penn.). He may require that the transferee obtain his consent for each license issued. *Thompson* v. *Johnson, Collector*, 50-2 U. S. T. C. 9428. He may prohibit the transferee from further assigning the interests conveyed. *Watson, et al.* v. *U. S.*, 222 F. 2d 689, 691 (Tenth Cir.); *Crook* v. *U. S.*, 135 F. Supp. 242, 252 (W. D. Penn.); *Dreymann* v. *Commissioner*, 11 T. C. 153, 161. He may retain rights and duties in connection with prosecuting and defending infringement suits. *First National Bank of Princeton* v. *U. S.*, 136 F. Supp. 818, 822 (D. N. J.). He may retain the power to transfer the license which he reserved or which was set over to him by his

assignee to one other person if he himself does not elect to use it. *Kavanagh* v. *Evans*, 188 F. 2d 234 (Sixth Cir.). He may reserve the right to cancel upon the breach of some duty assumed by the assignee, such as assisting in prosecuting or defending the patent in infringement actions or paying royalties or upon the happening of some future event beyond the assignor's control which renders continuance of the agreement impractical. *Littlefield* v. *Perry*, 88 U. S. 205, 220; *Allen* v. *Werner*, 190 F. 2d 840 (Fifth Cir.); *First National Bank of Princeton* v. *U. S.*, 136 F. Supp. 818, 822 (D. N. J.); and *Dreymann* v. *Commissioner*, 11 T. C. 153, 161.

While in the cases cited an assignment or sale was not reduced to a license because there remained in the hands of the assigning patentee two, three or four of the legal interests mentioned, there is no case where all of them were held in his hands; and in the cases where a number of such interests remained in the patentee, there was a stronger context and evidence of intention to sell or assign than in the present case. It is necessary to draw the line somewhere, and it seems plain that Watkins came out of the agreements with such extensive interest that even assuming, arguendo, an initial assignment in the granting clause of the contract between him and Watkins Patents, Inc., he finally as a result of the whole transaction, conveyed no more than a license. In making this overall determination, this court is mindful of the apparent intent of Congress:

> "The section does not detail precisely what constitutes the formal components of a sale or exchange of patent rights beyond requiring that all substantial rights evidenced by the patent (other than the rights to such periodic or contingent payments) should be transferred to the transferee for consideration. This requirement recognizes the basic criteria of a 'sale or exchange' under existing law, with the exception noted relating to contingent payments, which exception is justified in the patent area for 'holders' as herein defined.

> . . . Moreover, the courts have recognized that an exclusive license agreement in some instances may constitute a sale for tax purposes even where the right to 'use' the invention has not been conveyed to the licensee, if it is shown that such failure did not represent the retention of a substantial right under the patent by the licensor. It is the intention of your committee to continue this realistic test, whereby the entire transaction, regardless of formalities, should be examined in its factual context to determine whether or not substantially all rights of the owner in the patent property have been released to the transferee rather than recognizing less relevant verbal touchstones. . . ."
> *Report of the Committee on Finance, United States Senate,* to accompany H.R. 8300, dated June 18, 1954, page 439.

In none of the cases decided in favor of a patentee is there an example of the retention of such extensive powers as there is in those which Watkins kept to himself. Once he had left the employ of Dillman Industries, Inc., which he could do at his own volition after a year, Watkins could associate himself with another to manufacture and sell and that other would gain and retain a license even after Watkins had become disassociated from him; and thereafter Watkins could make a new association with someone else, who would thereby also gain a license and so on without limit. At the same time he could veto the granting of licenses by Watkins Patents, Inc. to someone of whom he did not approve. He possessed power to do more than his transferee could do.

After considering all of the evidence and the claim of the parties, it must be concluded that the plaintiffs have failed to establish that James R. Watkins and those contracting with him either intended or accomplished a sale or assignment of the patents to Watkins Patents, Inc. and that the payments in question must be treated as ordinary income and not as capital gains.

Judgment, with costs, may enter in favor of the defendant against the plaintiffs.

Dated at New Haven, Connecticut, this 12th day of March, A. D. 1957.

ROBERT P. ANDERSON
United States District Judge

(SEAL)

JUDGMENT

(Caption omitted) (Tr. p. 164)

This cause came on to be heard on December 21, 1956, and was argued by counsel, and thereupon, upon consideration thereof, the Court filed its "Finding of Fact, Conclusions of Law and Discussion" which provides that judgment, with costs, may be entered in favor of the defendant against the plaintiffs.

It is accordingly Ordered, Adjudged and Decreed that the plaintiffs take nothing, that the action be and it hereby is dismissed on the merits and that the defendant have and recover from the plaintiffs its costs in the action.

Dated at New Haven, Connecticut, this 12th day of March, 1957.

GILBERT C. EARL, Clerk

Approved as of March 12, 1957.

ROBERT P. ANDERSON,
United States District Judge